

Developments of Regional Financial Structure in Indonesia 1985-2011 (Case Study of Papua Province)

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Submission date: 13-Feb-2020 03:17PM (UTC+0700)

Submission ID: 1256693852

File name: Development_of_Regional_Financial_Structure.pdf (174.26K)

Word count: 4448

Character count: 23561

1 Developments of Regional Financial Structure in Indonesia 1985-2011

(Case Study of Papua Province)

1. Introduction

Based on Indonesian Law No.22/1999 about local government, thus, since 1999 governmental system that is more decentralized has been undergone effectively in Indonesia. Then, in 2001, based on Indonesian Law No. 25/1999 about balancing the finance of local government, the concept of government decentralization is completed with the implementation of fiscal decentralization. The main reason of fiscal decentralization is to fulfill the democratic goal and welfare in the society (Simarjuntak, 2008)

The year of 2011 is the first year of the second decade in which the fiscal decentralization is undergone. It is a good time to do a contemplation or evaluation about the use of fiscal decentralization in Indonesia during the first ten years. Has the fiscal decentralization in the first ten years reached the main goal? At least, does the goal of fiscal decentralization have the same message in the reformation? The most important question is, "Has the fiscal decentralization made Indonesia closer to the main goal of national development just like what it is written inside the Constitution of Indonesia 1945?" The result of the evaluation will give some benefit in determining the next steps. Will the fiscal decentralization be continued? What improvements should be made accordingly?

The province of Papua, since 2001, has been undergoing fiscal decentralization. Political improvements have resulted in giving Papua¹ the special autonomy status. The aim of giving this special autonomy status to Papua is the acceleration of the society welfare through the acceleration of economy. This is why the biggest portion of the cost for special autonomy is allocated for education and health care (Ministry of Finance, 2005).

The question is whether the goals of fiscal decentralization has been achieved, or has been indicated to reach the goals? Has the financial structure improved? Has the

¹ Another province with special autonomy status is Aceh (Nanggroe Aceh Darussalam)

welfare of the society got better? Those questions have become the motives of this study. Considering the focus of this discussion and the in-depth analysis, thus the main discussion of fiscal decentralization in Papua is restrained in the income area. The aim of this study is to analyze if the fiscal decentralization has improved the financial income of the local government of Papua.

2. Fiscal Decentralization and Improvement of Local Government's Finance

The analysis of local government's finance has the aim to evaluate the development status of balance and health of structural income. The result of the evaluation shows not only the management of local collective life that generates improvement in social welfare, moreover, to analyse whether the social welfare achieved the implementation of efficiency and effectiveness of the local financial management.

One way to evaluate whether the income structure is good or bad is to observe the tax portion in the total of governmental income. The structure is stronger when the role of tax income is bigger. Statistics in modern countries show that 90% of their incomes come from the tax. Empirical data from Lewis (2001) as quoted (Siddik, 2009), shows that generally the total income of tax in central government is bigger than the income of tax in local government. The same pattern also occurs in Indonesia, the portion of local revenue in local government is less.

On the other hand, governmental income structure is determined by the level of economic development. Generally, the more improved the economy, the more tax will be gained from it. This is caused by the developed economy which has a bigger potential of tax and a more efficient taxation system. Whereas, bad economic condition could not gain tax in a big portion mainly because of the low tax potential (Purohit, 2005).

Financial systems have to make consideration regarding the stability of macroeconomic aspect (Sumarlin, 2000). Decentralized system does not only have the chance of failure, but can also disrupt the stability of national macro economy. International world shows if a nation decentralizes financial responsibility greater than resources provided, then public services will decrease, or locals will suppress central government. On the other hand, if income resources are decentralized, financial mobility will decrease and the imbalance of macroeconomic will later become a problem. Moreover, if income and outcome can be decentralized well, the potential of failure still

exists, because of a weak capacity of local government administration (Bird and Vaillancourt, 2000). To guarantee the success of fiscal decentralization as an instrument of macroeconomic management, a *Grand Design* is needed (Simanjuntak, 2008).

2. The Experience of Papua Province

The discussion on fiscal decentralization has been going on since the birth of Republic of Indonesia. Since its independence (1945), Indonesia has undergone three governmental order, Old Order (1945-1966), New Order (1966-1998), and Reformation (1999-now). The fall of governmental orders in Indonesia were triggered by dissatisfaction on social-economic condition and governmental system that was too centralized.

The transition between orders has both direct and indirect consequences to the government financial system. In the New Order, the reporting system of national and local budget uses the T scale which consists of two rows (T account), whereas Reformation Era uses the I scale (one row). In the New Order, the income structure consists of five main components, they are: The Excess Budget, Local Revenue, Shared Revenue, Aid and Donation, and Development Income. This grouping is then simplified into three: Local Revenue, Shared Revenue, and transfer which consist of Aid and Donation, and Development Income.

The local revenue in the Reformation Era is not different than it was in the period of fiscal decentralization. The difference can be seen in the Balancing Financial that consists of shared revenue, general allocation fund, and special allocation fund. But general allocation fund and special allocation fund can be grouped as transfer from central government to provinces. Because basically the aims of general and special allocation fund² are not far from the aim of aid and donation in pre-decentralization era, so they can be categorized as Aid and Donation, in Reformation Era. Other income components, based on the explanation from Ministry of Finance (2005), can not be grouped as general and special allocation fund. Because of this condition, other income can be categorized as Other Transfers.

² According to empirical data in Papua, the role of special allocation fund is relatively small, so this paper discusses about public transfer during fiscal decentralization period.

Therefore, the income structure of the provinces in Indonesia has not changed even though fiscal decentralization is done, since 2001. The income resources of local government still consist of Local Revenue, Shared Revenue, and General Transfer and Other Transfers. These four components will later be used as the basis of local income structural development analysis of Papua Province in 1987/1988 to 2011³.

- Regional Revenue

Regional revenue is the revenues that come from local taxation, local retribution, profit of government business enterprises, and other earnings, such as earning from officials. The amount, composition, and the growth of regional revenue give an illustration of local government's capability to manage taxation system and non taxation. The improvement of regional revenue shows an improvement in potension and efficiency of local income.

- Shared Revenue

Shared revenue is a source of income which basically pays attention to the potension of producer (Ministry of Finance, 2005). Shared Revenue, during pre-decentralization and decentralization period, consists of tax sharing and non-tax sharing. In the decentralization era, it is explicitly explained that personal income tax is included in tax sharing⁴ (Constitution of Indonesia No. 21).

- Public Transfer

In pre decentralization era, transfer consisted of Aid and Donation. Donation is given to local government to help recover from financial difficulties, such as retribution, financial balancing, and financial subsidiary for public school. Aid is a development help from presidential instruction and other helps, like regional development.

- Other Transfer

In the period of pre decentralization, other transfer was the income of local development on level I, which came from loans for expenditure that consisted of governmental loans and local business enterprises. In decentralization period, Other Transfer is Other

³ The definitions of four components of governmental income in this discussion is referred to the definitions in the book of *Statistik Keuangan Daerah Tingkat I* (New Order version) and *Statistik Keuangan Provinsi* (Reformation Order version), published by BPS.

⁴ Further details, Ministry of Finance (2005)

Rightfully Income. The income comes from central government. Other incomes consist of emergency fund of disaster, public fund, special fund, and others.

3.1 The Development of Income Structure

As explained before, four admission components that will be discussed are local revenue, shared revenue, public transfer, and other transfers.

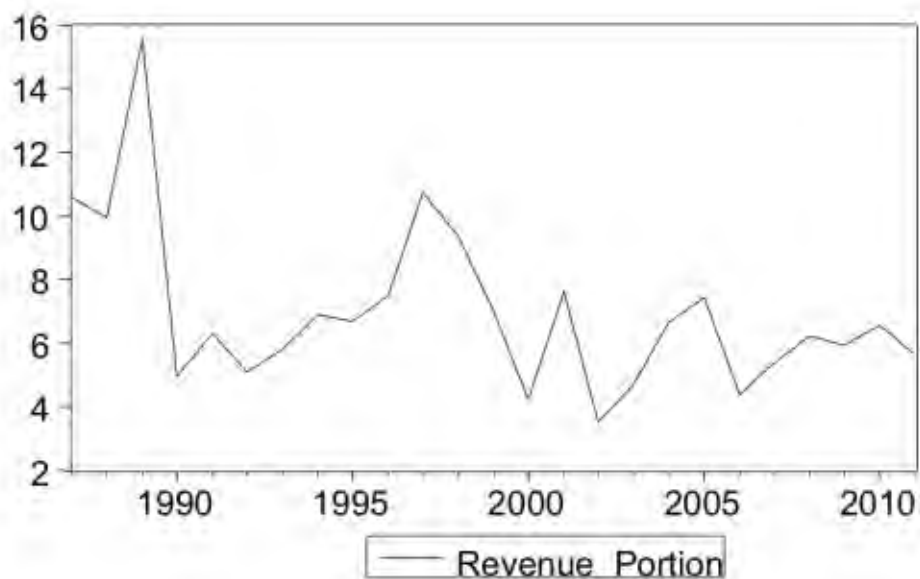
A. Local Revenue

The role of local revenue in Papua is quite small. In 1987/1988-2011, the donation of revenue was only around 7% of the total income of the province. The biggest donation of 15.6% was achieved by Papua in 1989. In other hand, the lowest donation was only 3.5% in 2002. Moreover, the role of local revenue tended to decrease in Papua. The degradation of local revenue happened during the fiscal decentralization period which can be observed from Graph 1 below.

Drastic and consisten degradation could be seen in 1990/1991 to 1996/1997 and this kept going especially in fiscal decentralization period. Very steep role degradation was in 1989/1990 – 1990/1991. Despite the increment in 1991/1992 – 1998/1998, after the year of 2000 the role of local revenue has been decreasing. Before decentralization, the role of local revenue was only 8.2% from total governmental income of Papua. During this period, the role was also decreased to 5.8% and never reached 8% of the whole governmental income. Data shows that since 1987/1988, the value of Papua's revenue has had the tendency to improve.

Graph 1

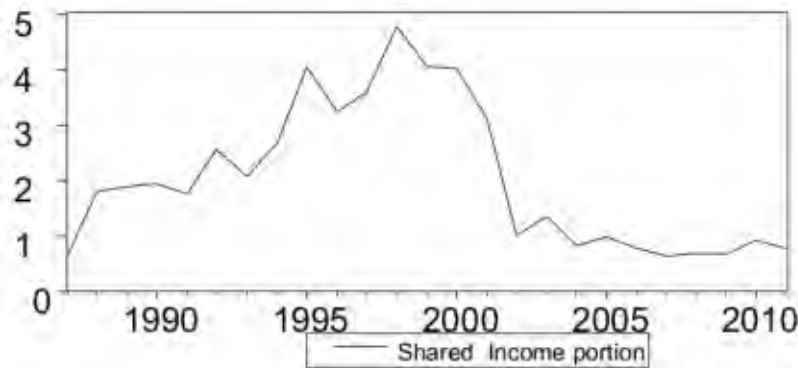
The Role Improvement of Local Revenue within Local Governmental Income of Papua Province
1987/1988-2011 (% Local Governmental Income of Papua)



During the pre decentralization period, the revenue of Papua grew approximately 22.5% per year and later decreased to 16.8% per year. The role decrement was caused by the growth of revenue that was lower than the growth of local governmental income. In pre decentralization period, the growth of local income was 26.8% per year. Compared to national average, the role of local revenue within local governmental income in Papua is relatively low. Averagely, the role of Indonesian provincial revenue in 1987/1988-201 is approximately more than 30% of income. Thus, in the last 25 years, the role of local revenue is in average amount in the whole Indonesian provinces.

B. Shared Income

Graph 2 below shows that after the role increment during pre decentralization period, the role of shared revenue in Papua decreased drastically.



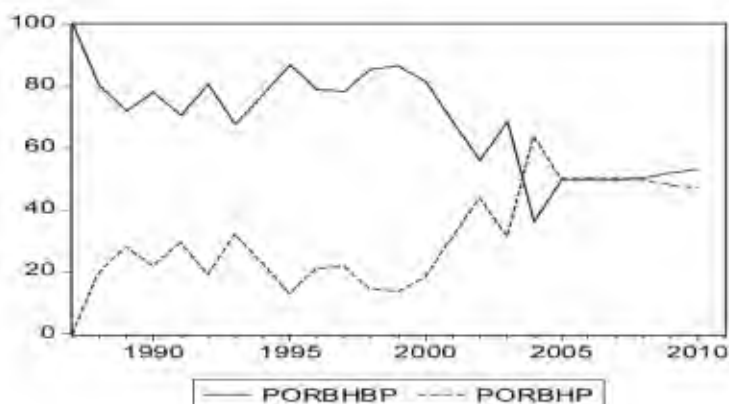
Graph 2

The Role Improvement of Shared Income within Local governmental Income of Papua

In 1987/1988 until 2011, shared income donates approximately 20.4% from the whole provincial income of Papua. The highest role was 47.7% in 1998, whereas the lowest role was 6.5% in 1987. In 1987/1988 – 1999/2000, there was tendency for a quick increment. In 1987/1988, the role of shared income was only 6.6% of provincial income, but in 1999/2000 it increased to 40.7%. Thus, during the pre decentralization period, the role of shared income of Papua increased averagely 16.4% per year.

Entering the decentralization period, the role of shared income decreased drastically to 10.7% in average. This was caused by the growth of shared income was lower than the growth of local government income. The decrement of shared income was related to the slow growing of non-tax shared income. In 2001 to 2010, the growth of non tax shared income was only 5.3% per year. In a short time observation, non tax shared income experienced stagnancy in 2001-2007. But in 2007-2010, non tax shared income was beginning to increase slowly.

The composition of shared income changed fundamentally which can be observed in Graph 3 below.



Graph 3

The Role improvement of Shared Tax Income and Non Tax Shared Income within Governmental Shared Income of Papua 1987/1988-2011 (% Shared Income)

In 1987/1988-2011 there was a consistent increment pattern of shared tax's role and a consistent decrement of non tax shared income in Papua Province³. In 1987/1988 until 2011, the donation of shared tax income was averagely 31%. In 1987/1988 to 1999/2000 the role of shared tax income was 19%. Thus, it can be inferred that during pre fiscal decentralization period, the role of shared tax income in provincial income of Papua was only a quarter of the non tax shared income's role. Entering fiscal decentralization period (2001-2010), the role of shared tax in Papua was greater. During this period, the role of shared tax income was 46% of local governmental income. Compared to pre fiscal decentralization period, the role of shared tax income was twice as much. Only in 2004-2007, the role of shared tax income could exceed 50%.

The development of shared income as explained above shows that the government of Papua still relies on natural resources in increasing income.

³ Data of shared income in 2011 combined, so the portion of shared tax income and non tax shared income cannot be obtained.

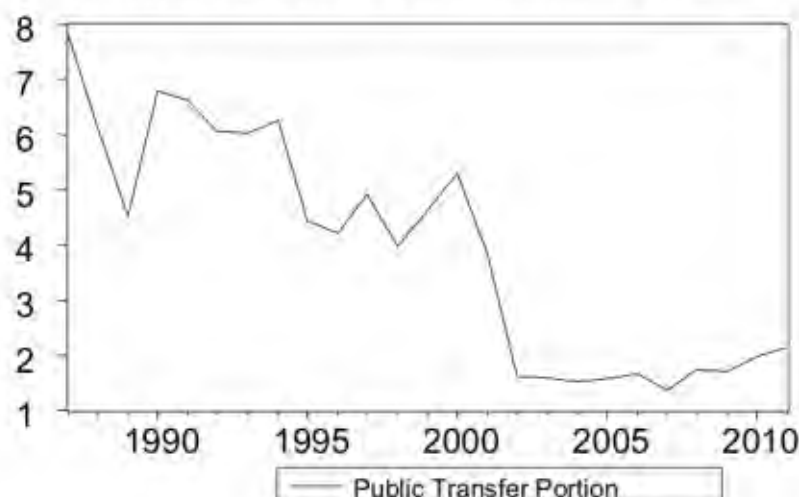
Compared to national average, there are some conclusions. First, during pre fiscal decentralization period, the role of shared tax income within the local government of Papua is greater than national average. Second, shared tax income in Papua is dominated by non tax shared income, while nationally, the role of non tax income is only half of shared tax income.

C. Public Transfer

Graph 4 below shows that the role of public transfer within Papua governmental income has decreased drastically in 1987/1988 until 2011

Graph 4

The Role Development of Public Transfer within Local Governmental Income of Papua 1987/1988-2011 (% Income of Local Governmental in Papua)



During pre decentralization period, the role of public transfer reached 55.7% of provincial income in Papua. This situation shows that there was dependency towards central government, because more than half of the income came from central government. In decentralization period, the role of public transfer decreased to 18.9%. The highest role was 38.6%. Thus, in fiscal decentralization period, aid and donation in Papua decreased significantly to less than 50% of Papua governmental income⁶.

⁶The development has to be observed thoroughly. The decrement of public transfer's role does not indicate the independency level on Papua. This decrement should be best related to political development in decentralization period, when special

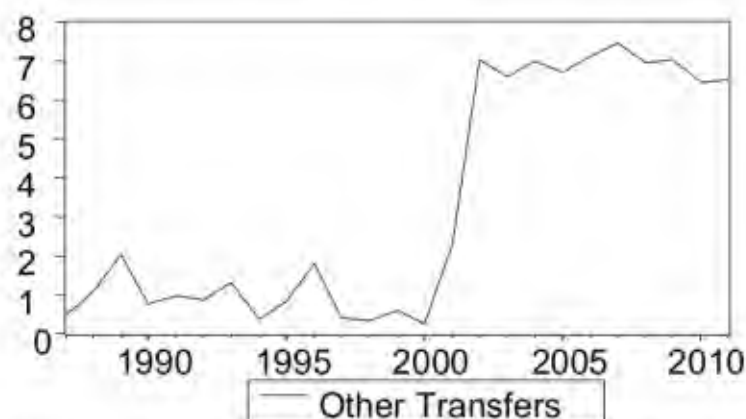
The role of public transfer within governmental income in of Papua is also greater than national average. In pre decentralization period, the role reached to 55%. This number is 50% higher than national average in the same period. In decentralization period, even though it only reached 19%, the role was still higher than national average.

D. Other Transfers

In 1987/1988 until 2011, the portion of other transfer was averagely 33.3% of provincial income. This condition was slightly lower than public transfer which was 39.3%. The role of other transfers surprisingly increased significantly in decentralization period, in 2006-2011. The pattern can be seen through Graph 5 below, it is very interesting to be observed.

Graph 5

The Role Development of Other Transfers in Local Governmental Income of Papua Province
1987/1988-2011



Graph 5 shows that until the end of pre decentralization period, the role of other transfer was usually 20% less than provincial income of Papua. Moreover, there was a tendency of decrement in 2000 and reached 10% less than provincial income. In 2001, the role of other

autonomy status was given to Papua. This political rule can cause increment of special autonomy fund. The role development of fund related to special autonomy of Papua can be observed through other transfers.

transfers increased almost 10 times bigger to 23%. Then, in 2002, the role increased to 70.3%. Thus, in just two years, the role of other transfer increased to thirty-five times greater.

During pre decentralization period, the role of transfer fund was only 9.1% of provincial income in Papua. Thus, in decentralization period, the role of other transfer was seven times bigger than the role in pre decentralization period.

The improvement on the role of other transfer can be explained with other incomes related to special autonomy status of Papua. The fund which is related to special autonomy status is called Compliance Fund and Special Autonomy. In 2006-2011, the total of other transfer reached approximately Rp. 20.4 trillion. It can be inferred that almost 100% of Papua governmental income was Rp. 33.6 trillion. Thus, in 2006-2011, the role of other transfer reached 61% of provincial income in Papua.

Significant improvement of other transfer in provincial income of Papua, especially in 2006-2011 can be observed and compared with other income resources in Table 3 below.

Table 3
The Relative Role Development of Other Income in Papua Province
2006-2011

No	Classification	2006	2007	2008	2009	2010	2011
1	Provincial income of Papua Province (Rp billion)	4.895	5.898	5.757	6.013	5.662	5.369
2	Local Revenue (Rp. billion)	215	345	358	370	380	304
3	Balance Fund (Rp billion)	1.192	2.044	1.437	1.563	1.763	1.570
4	General Allocation Fund (Rp billion)	810	876	1.002	1.058	1.149	1.149
5	Other Transfer (Rp billion)	3.488	3.509	3.962	4.080	3.519	3.495
6	Balance Fund portion (%)	24,4	34,7	25,0	26,0	31,1	29,2
7	Other Transfer portion (%)	71,3	59,5	68,8	67,8	62,2	65,1
8	Other Transfer/Balance Fund	2,9	1,7	2,8	2,6	2,0	2,2
9	Other Transfer/General Allocation Fund	4,3	4,0	4,0	3,9	3,1	3,0
10	Other Transfer/ Local Revenue	16,2	10,2	10,3	11,1	9,3	11,5

Source: Compiled from BPS data using records from many years. Note: 1) % is the percentage of Papua provincial income

The data in table 3 shows than in 2006-2011, the role of other transfer was around 59.5% to 71.3% of provincial income in Papua. The average number was 66% in 2006-2011. This condition shows that in the last six years of fiscal decentralization, there was 60% of provincial income that came from Compliance Fund and Special Autonomy. The data also shows than in 2006-2011, the amount of other transfer was averagely three times greater than

balanca fund, almost four times as much as general allocation fund, and almost twelve times greater than local revenue.

3.2. The Development of Local Revenue

The revenue development pattern describes the potential improvement and the ability to manage the resources of local income.

A. Local Tax

In 1987/1988, the donation from local tax was only 26.4% of revenue, but in 2011, it reached 76.5%. Thus, in the last 25 years, the role of local tax income has increased three times greater. The data in previous table shows that there was role improvement of local tax income during fiscal decentralization period. The average role was 68.5% which was greater than it was in decentralization period, 57.6% of revenue. So, the role of local tax was 19% greater than before decentralization period.

Even though the role of local tax has exceeded 50%, the role is still lower than national average. During pre decentralization period, the local tax's role was generally 70% higher. In decentralization period, though, the role has got closer to 70%. But the role of local tax in Indonesian provinces is around 80%.

B. Local Retribution

Despite the role of local tax that kept increasing, the role of local retribution decreased drastically. During decentralization period, the role of local retribution in Papua was approximately 6% of revenue. So, the role was only half of it was in pre decentralization period. The decrement pattern also happened in other provinces in Indonesia. In fiscal decentralization period, for example, in 1987/1988, local retribution donated around 19% of the whole Indonesian provincial income, but in 1999/2000, the role decreased to 6.1%. The role decrement kept going the whole decentralization period. In 2001, the role of retribution was only 4.7% of provincial income, but in 2010, the role was 2.6%.

C. Profit of Regional Owned Enterprises

The role of profit from ROE in Papua, during fiscal decentralization period also increased. In 1987/88-1999/2000, the donation from ROE was only 4.2%, but in decentralization

period, the role increased to 7.9%. Compared to national average, the role of ROE was getting better, especially in fiscal decentralization period. In pre decentralization period, the average role of ROE was less than %5 and kept decreasing. But in decentralization period, the ROE increased to almost 100% with the national role was still 4% lower than provincial income.

Beside the increment, the stability of ROE in revenue was getting better. This situation indicated that the profit from ROE can be seen as a reliable source of revenue in the future. Nevertheless, some things still have to be observed, it is whether the improvement of ROE really came from income improvement and efficiency of ROE management.

3. The Symptoms of Increasing Fiscal Dependency

One development which has to be examined thoroughly in structural income development of Papua Province is the fiscal dependency that was increasing. That condition can be seen from the symptoms of the increasing role of public transfer and other transfers within provincial income of Papua Province.

In pre fiscal decentralization period, the role of total transfer was averagely 64.8% of provincial income. This means that during that period, the transfer from central government to Papua, consisting aid and donation, was as much as 64.4% of provincial income. Between 1987/1988 – 1998/1999, the role of total transfer exceeded 80%. Entering the decentralization period, the role of total transfer was averagely 83.4% of provincial income. This was 40% higher than fiscal dependency level in pre decentralization period. In 2001, the role was 80% lower than provincial income, which was only 61.1%. In 2002-2011, the role of total transfer was always 80% of provincial income. Only in 2010, the role of total transfer was lower than 85%. In other years, the role of total transfer was always greater than 85% of provincial income.

Based on the last five years of observation, there has been a concern about the level of fiscal dependency that is chronic and tends to worsen if nothing is done to improve it.

Even though the situation will have to be examined, the increasing symptom of fiscal dependency in Papua is related to its special autonomy status. The great flow of special autonomy fund in the second period of decentralization is feared to weaken governmental initiative of Papua in discovering income resources. This symptom has actually occurred since the decrement of local tax and local retribution during decentralization period. This is an

inversed situation with the growth of national development which generally shows fiscal dependency in the provinces.

The fast growing of special autonomy fund in Papua also leads to concerns in the managing capability area. This situation is caused by the fast growth of governmental administration with the complexity of its programs compared to the growth of local bureaucracy with the quality and quantity of governmental personnels. Moreover, the human resources in Papua has been facing problematic situations with institutions that are still incapable of executing fiscal decentralization. The audit result of BPK shows there is approximately Rp. 11.4 billion of special autonomy fund which usage cannot be accounted. The amount is about half of the special autonomy fund allocated to Papua.

The biggest concern occurs when evaluating the distribution of the fund related to people's welfare. Despite the increasing national budget for Papua, the welfare of Papuan society is still not getting any better. Ruben Magai, one of the Papua Parliament members states that up to now, Papua still stands as one of the poorest provinces in Indonesia.

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